Supreme Court, U. S.
FILED
MAR 7 1976
MICHAEL RODAK, JR., CLERK

# In the Supreme Court of the United States

OCTOBER TERM, 1975

**No. 75-1038**

DIAMOND NATIONAL CORPORATION,
a Delaware corporation,
*Appellant,*

vs.

STATE BOARD OF EQUALIZATION,
an agency of the State of California,
*Appellee,*

---

CROCKER CITIZENS NATIONAL BANK,
a National banking association,
*Appellant,*

vs.

STATE BOARD OF EQUALIZATION,
an agency of the State of California,
*Appellee.*

---

On Appeal from the Court of Appeal of the State of California, First Appellate District, Division Two

---

## Motion to Dismiss or Affirm

---

EVELLE J. YOUNGER
Attorney General

ERNEST P. GOODMAN
Assistant Attorney General

PHILIP M. PLANT
Deputy Attorney General

6000 State Building
350 McAllister Street
San Francisco CA 94102
(415) 557-2515

*Attorneys for Appellee*

SORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

INDEX


Page

Summary of Case ..... 2

The Jurisdictional Statement Does Not Accurately Reflect the Stipulated Facts ..... 7

Argument

The Question Presented Herein, Having Been Resolved by Prior Decisions of This Court, Is Neither Substantial Nor Important ..... 9

A. There Is No Mandatory Pass On Requirement Under the California Sales Tax Law ..... 9

B. The Jurisdictional Statement Ignores the Fact That the California Sales Tax and the Massachusetts Sales Tax Are Fundamentally Different Insofar as the Former Merely Permits Optional Sales Tax Reimbursement Whereas the Latter Requires That the Sales Tax Be Passed on to the Purchaser; This Court's Decisions Make Clear This Distinction Is Controlling With Regard to Legal Incidence ..... 12

C. The Decision Below Is in Accord With the Decisions of This Court ..... 14

D. The Arguments of Appellants Are Without Merit ..... 17

E. The Arguments of Amicus Curiae Are Without Merit ..... 20

Conclusion ..... 22

Appendices Follow

## TABLE OF AUTHORITIES


| Cases | Pages |
|---|---|
| Ainsworth v. Bryant, 34 Cal.2d 465, 211 P.2d 564 (1949) | 3 |
| Alabama v. King & Boozer, 314 U.S. 1 (1941) | 21 |
| Clary v. Basalt Rock Co., 99 Cal.App.2d 458, 222 P.2d 24 (1950) | 10 |
| Coast Elevator Co. v. State Board of Equalization, 44 Cal.App.3d 576, 118 Cal.Rptr. 818 (1975) | 10 |
| Colorado National Bank v. Bedford, 310 U.S. 41 (1940) | 16 |
| DeAryan v. Akers, 12 Cal.2d 781, 87 P.2d 695 (1939) | 17 |
| Decorative Carpets, Inc. v. State Board of Equalization, 58 Cal.2d 252, 373 P.2d 673 (1962) | 18 |
| First Agricultural Bank v. State Tax Commission, 229 NE2d 245 (1967) | 12 |
| First Agricultural Bank of Berkshire County v. State Tax Commission, 392 U.S. 339 (1968) | 2, 3, 4, 12, 14, 15, 16, 17, 19 |
| Gurley v. Rhoden, 421 U.S. 200 (1975) | 2, 3, 15, 16, 17, 18, 19 |
| Henneford v. Silas Mason Co., 300 U.S. 577 (1937) | 21 |
| Javor v. State Board of Equalization, 12 Cal.3d 790, 527 P.2d 1153 (1974) | 18 |
| Kern Limerick Inc. v. Scurlock, 347 U.S. 110 (1954) | 21 |
| Meyer Const. Co. v. Corbett, 7 Fed.Supp. 616 (1934) | 4, 11 |
| Michelin Tire Corp. v. Wages, 44 L.W. 4070 (1/14/76) | 21 |
| National Ice, etc. Co. v. Pacific Fruit Express, 11 Cal. 2d 283, 79 P.2d 380 (1938) | 4, 10, 18 |





| | Pages |
|---|---|
| Pac. Coast Engineering Co. v. State of California, 111 Cal.App.2d 31, 244 P.2d 21 (1952) | 10, 18 |
| Panhandle Oil Co. v. Knox, 277 U.S. 218 (1928) | 21 |
| St. Louis S.W. Ry Co. v. Arkansas, 235 U.S. 350 | 9, 22 |
| Tradesmens Bank v. State Tax Commission, 309 U.S. 560 (1939) | 21 |
| United States v. City of Detroit, 355 U.S. 466 (1958) | 21 |
| United States v. Mississippi Tax Commission, 421 U.S. 599 (1975) | 2, 3, 16, 17 |
| United States v. Nevada Tax Commission, 291 F.Supp. 530, (D.Nev. aff'd 439 F.2d 435, (9th Cir. 1971)) | 19 |
| United States v. State Board of Equalization, CA 9 No. 74-3360 | 5, 6, 20, 21 |
| Western Lithograph Co. v. State Board of Equalization, 11 Cal.2d 156, 78 P.2d 731 (1938) | 3, 10 |


### Constitutional Provisions, Statutes and Administrative Regulations


| | Pages |
|---|---|
| Federal: | |
| Decisions of the Controller of the United States, A 88689, promulgated 1/31/42 | 11 |
| Internal Revenue Ruling, XII-47 6518 IT 2733 | 11 |
| Revenue Act of 1942, Section 122 | 11 |
| State: | |
| California Administrative Code, Section 1700 of Title 18 | 8 |
| California Revenue and Taxation Code | |
| Section 6001 | 2 |
| Section 6051 | 6, 9 |

| | Pages |
|---|---|
| Section 6052 | 9, 10, 11 |
| Section 6053 | 9, 10 |
| Section 6066 | 9 |
| Section 6452 | 9 |
| Section 6481 | 9 |
| Section 6511 | 9 |
| Section 6937 | 9 |
| California Sales Tax Law | |
| Section 4 | 5 |
| Section 8½ | 11 |
| Massachusetts Sales Tax Law | |
| Subsection 1 | 9 |
| Subsection 3 | 15 |
| Other Authorities: | |
| Opinions of the Attorney General, No. 540, 9/18/68 (CCH State Tax Reporter, Nevada Par. 200-455) | 20 |
| State and Local Sales Taxation (1972), by John Due | 13 |
| The New Sales & Use Tax Law, by John Dane, Jr., 51 Mass Law Quarterly 241 | 13 |


# In the Supreme Court of the United States

OCTOBER TERM, 1975

**No. 75-1038**

DIAMOND NATIONAL CORPORATION,
a Delaware corporation,
*Appellant,*

vs.

STATE BOARD OF EQUALIZATION,
an agency of the State of California,
*Appellee,*

---

CROCKER CITIZENS NATIONAL BANK,
a National banking association,
*Appellant,*

vs.

STATE BOARD OF EQUALIZATION,
an agency of the State of California,
*Appellee.*

---

On Appeal from the Court of Appeal of the State of California, First Appellate District, Division Two

---

## Motion to Dismiss or Affirm

Appellee, pursuant to Rule 16 of the Revised Rules of the Supreme Court of the United States, moves the Court to dismiss these appeals or to affirm the judgment of the

Court of Appeal, First Appellate District of the State of California.

There is no substantial federal question presented as a basis of jurisdiction in this Court inasmuch as the questions have been foreclosed by previous decisions of this Court. The decision of the Court of Appeal correctly applies the standards enunciated by this Court in *First Agricultural Bank of Berkshire County v. State Tax Commission,* 392 U.S. 339 (1968) (hereinafter sometimes referred to as *Berkshire*); *Gurley v. Rhoden,* 421 U.S. 200 (1975) and *United States v. Mississippi Tax Commission,* 421 U.S. 599 (1975).

## SUMMARY OF CASE

The California sales tax (California Revenue and Taxation Code Section 6001, et seq.) is imposed on retailers for the privilege of selling tangible personal property at retail, measured by the retailer's gross receipts. The statute imposing the California sales tax has been consistently construed, applied and administered for almost 40 years as a pure "vendor" tax which creates *no* obligation of any kind on the consumer and thus gives the retailer absolutely no right (let alone any duty) to pass the sales tax on to his purchaser. The sole issue presented by this case is whether this California sales tax is to be regarded as being imposed on the purchaser as a matter of federal law when the purchaser is a federal instrumentality.

Contrary to the statement at page 2 of the Jurisdictional Statement, the Court of Appeal did not conclude that the California sales tax was collected from the purchaser pursuant to the provision of the California law. Rather, the Court of Appeal concluded that no federal right was violated when Crocker, a national bank, contracted to pay sales tax reimbursement as part of the purchase price for



supplies it acquired from Diamond. The Court of Appeal concluded that since under the California sales tax law the retailer has no rights against the purchaser and it is optional with the parties as to whether they wished to contractually add sales tax reimbursement to the sales price, the legal incidence of the sales tax is on the retailer, Diamond.

For over thirty years California national banks acquiesced in the proposition that the legal incidence of the sales tax was on the retailer. *Western Lithograph Co. v. State Board of Equalization,* 11 Cal.2d 156, 78 P.2d 731 (1938). The present challenge to the California tax is based on their erroneous belief that this Court in *Berkshire,* supra, adopted a new standard to determine the legal incidence of a tax.

A review of this Court's decisions, particularly *First Agricultural Bank of Berkshire County v. State Tax Commission,* 392 U.S. 339 (1968), *Gurley v. Rhoden,* 421 U.S. 200 (1975), and *United States v. Mississippi Tax Commission,* 421 U.S. 599 (1975) demonstrates that the California sales tax was validly applied in the instant case to the gross receipts of Diamond arising from its sales to Crocker National Bank and that appellants simply misunderstand the criteria utilized by this Court in the cases mentioned above. In all of the listed cases it was made clear that the legal incidence of an excise tax turns upon whether there was a mandatory requirement that the tax be passed on to the purchaser. No such mandatory pass on requirement exists under California law.[1] Therefore, the incidence of the tax remains on the retailer.

---

1. Cases collected in *Ainsworth v. Bryant,* 34 Cal.2d 465 at 473-474, 211 P.2d 564 at 569 (1949) demonstrate that the California sales tax has been consistently construed and applied as a purely "vendor" type tax giving the retailer no rights against the purchaser.

The same decisions of this Court make it clear that it is not significant as far as the legal incidence is concerned that a vendor may choose to shift the *economic burden* of the tax to a federal instrumentality. Rather, in order to preserve federal supremacy, this Court has stricken down only those state taxes which the state by law or regulations *require* be passed on to a federal instrumentality, i. e. which give the retailer a state sanctioned right to require payment of the tax by the purchaser.[2] It is only under such circumstances that there is state action directly affecting the federal instrumentality and thus a prohibited state encroachment on federal sovereignty. The fact that a retailer, such as Diamond, and a purchasing national bank, such as Crocker, agree that the retailer, in order to cover his costs, may include as part of his selling price reimbursement for his sales tax liability has been stated by this Court to be not violative of the principle of federal supremacy. *Berkshire,* supra, at pages 346, 347.

About forty years ago the California Supreme Court, by recognizing that the legal incidence of the sales tax is on the vendor alone, held unconstitutional and thus eliminated from the California sales tax law a provision which would have allowed a retailer to pass on the California sales tax without the consent of the purchasers as to contracts entered into prior to the enactment of the Sales Tax Act. *National Ice, etc. Co. v. Pacific Fruit Express*, 11 Cal. 2d 283, 79 P.2d 380 (1938)[3]

2. The federal district court in *Meyer Const. Co. v. Corbett,* 7 Fed. Supp. 616, 618 (1934), recognized this when it found that the California Retail Sales Act was a tax on the retailer noting: "The Retail Sales Tax Act creates the relationship of sovereign power and taxpayer between the state the retailer, and not between the state and the consumer."

3. This case shows how the California sales tax actually operates. The California Supreme Court held unconstitutional section 4 of the California Sales Tax Act, which would have allowed sales tax reimbursement to be added to contracts entered into prior to the enactment of the California Sales Tax Act. The Court concluded that since the Legislature intended the sales tax to be imposed on retailers and not purchasers, sales tax reimbursement could not be added to the selling price in the absence of the purchaser's consent. The Court held section 4 severable so that the Sales Tax Act was valid despite the elimination of that section.



Under the California sales tax there simply is no statutory requirement that makes the purchaser liable for the tax or gives the retailer any rights against the purchaser. The purchasers' liabilities, if any, are contractual. This fact was also recognized forty years ago by the Internal Revenue Department of the United States and the Controller General of the United States in ruling that the legal incidence of the California sales tax for federal purposes was on the retailer and not the purchaser. See Appendix A and Appendix B hereto.

The Solicitor General has filed an amicus curiae brief urging that this Court note probable jurisdiction. It points out that a case now pending in the Court of Appeal for the Ninth Circuit (*United States v. State Board of Equalization,* CA 9 No. 74-3360) presents the same issue with respect to the application of the California sales tax to lessors to the federal government. The Board agrees that the same issue is presented in both cases.[4] Appellants also refer to this pending Ninth Circuit appeal in their Jurisdictional Statement. As the Solicitor General appears to adopt appellants' line of argument in its memorandum, appellee's response thereto will be incorporated into this document.

Appellants and amicus curiae have both failed to accurately state the issue, the facts or the applicable California

4. The federal government has also raised the issue that even though equal burdens are imposed with respect to all leases of tangible personal property in California by virtue of complementary taxes, nevertheless, there is "invideous discrimination" against the federal government.

law in their briefs. Thus, the statement of questions presented by appellants' Jurisdictional Statement (hereinafter "J.S.") pages 3 and 4, is misleading because it suggests that the question of legal incidence is a "subsidiary question," "among others". This is the only question. No one asserts any unconstitutionality except on the contention that the legal incidence of the sales tax is on the purchaser. Further, appellants mischaracterize the California sales tax, calling it a tax "applied to sales". It is not. The California sales tax is a tax on the retailer for the privilege of engaging in business, measured by his gross receipts from sales. (California Rev. & Tax. Code § 6051).

Amicus curiae also misstates the question presented. Amicus curiae, rather than presenting any cogent argument seems content to merely keep quoting out of context portions of one sentence of the California sales tax law while refusing to recognize that the quoted language has for almost forty years been interpreted and applied consistently by California and federal courts as well as by state and federal administrative agencies to mean something very different from what amicus curiae hopes this Court will infer it to mean. (Amicus curiae brief, pages 2 and 3). The refusal of amicus curiae in this regard is particularly curious in light of the fact that it stipulated to this consistent interpretation of the California sales tax as purely a "vendor" type tax in the case of *United States v. State Board of Equalization* with which it is most immediately concerned.[5]

5. This stipulation of facts (without the exhibits thereto) is set forth as Appendix C hereto. Paragraph 16(a) of the stipulation states:

> "16. Under the California Sales and Use Tax Law:
>
> "(a) Since 1933, sales tax is imposed on a seller for the privilege of selling tangible personal property in California at retail; the legal obligation to pay the sales tax is on the seller; the buyer has no obligation to or rights against the State of California; a sales tax may be lawfully imposed even though the user be exempt from sales and use tax; *the seller has no rights (except those created by contract between seller and buyer) to reimburse to himself or otherwise recover from the buyer the amounts of sales tax paid by the seller;* it is the prevailing (but not uniform) practice, however, for the buyer and seller to separately state and collect sales tax reimbursement in their sales agreement; . . ." (Appendix A, page 4, ¶ 16(a).) (emphasis added)

It is further stipulated in Paragraph 17 that the foregoing statement "represents a consistent and repeated forty year interpretation of the sales tax administrator, California Legislature, California Attorney General and state and federal courts."



## THE JURISDICTIONAL STATEMENT DOES NOT ACCURATELY REFLECT THE STIPULATED FACTS

The facts as stated in the Jurisdictional Statement fail to accurately reflect the Stipulation of Facts agreed to by the parties in several vital particulars. In this regard, it is most significant that appellants avoid mention of the contractual basis for the payment of sums here in issue. It was expressly stipulated that:

> "Crocker and Diamond entered into a contract whereby Diamond would furnish supplies needed by Crocker at a stated price per item. [Stip. Par. 7, C.T. 27] • • • •
>
> "At the time of the sales transactions here involved and for many years prior thereto, it was understood and agreed between Crocker and Diamond that the prices stated by Diamond were exclusive of 'sales tax reimbursement' which would be added to the stated price Crocker would pay Diamond for the merchandise." (Stip. Par. 10, C.T. 29.)

This is so since under California law sales tax reimbursement is a matter of voluntary contractual arrangement between buyer and seller.

In addition, appellants' assertions are at variance with Regulation 1700 of the Board of Equalization respecting sales tax reimbursement. (California Administrative Code section 1700 of Title 18). The express language of this regulation is set forth in the stipulation of facts (Stip. 22, C.T. 33, 34) and directly contradicts appellants' assertion that California retailers are "required to separately state and collect the tax." J.S. 9.[6] Thus, Regulation 1700 evidences the optional nature of the California reimbursement procedure in general and of separate statement of reimbursement in particular and recognizes that a retailer need not separately state the amount of sales tax reimbursement.

As will be discussed more fully herein, there is no requirement under California law that the retailer collect any sales tax reimbursement from the purchasers.

In addition, it was expressly stipulated that the $13,911.94 here in controversy was to be referred to as "sales tax reimbursement."[7] (Stip. 9, C.T. 28, 29). The Jurisdictional Statement at page 5, although purporting to reflect the Stipulation of Facts, conveniently omits the word "reimbursement" in its description of the payments in controversy thereby begging the ultimate issue presented herein.

---

6. Paragraph 22 of the Stipulation of Facts is set forth in Appendix J of the Jurisdictional Statement.

7. In that regard it was stipulated that the designation of such sum as "sales tax reimbursement" was not intended to resolve the legal nature of these amounts added to stated price since this was a legal issue in the case. (C.T. 29).



## ARGUMENT

### The Question Presented Herein, Having Been Resolved by Prior Decisions of This Court, Is Neither Substantial Nor Important

#### A. THERE IS NO MANDATORY PASS ON REQUIREMENT UNDER THE CALIFORNIA SALES TAX LAW.

This Court has stated that in a matter involving federal rights, it will look to the operation and effect given to a state statute. *St. Louis S.W. Ry Co. v. Arkansas,* 235 U.S. 350, 362 (1914). For forty years the actual operation of the California sales tax law has been in accordance with the construction placed upon it by the California appellate courts and by the State Board of Equalization, the agency charged with its enforcement, i.e. that it is strictly a "vendor type" sales tax creating no rights against purchasers.

It is clear that the California sales tax is a privilege tax upon a retailer measured by gross receipts (Rev. & Tax. Code § 6051); and that only the retailer has any duty to make payments to or receive refunds from the State of California. (Rev. & Tax. Code § 6066 [permits], § 6452 [returns], §§ 6481, 6511 [determinations], § 6937 [nonassignability]

Were there nothing else, there would be no litigation. However, the California sales tax statute does also provide "The tax hereby imposed shall be collected by the retailer from the consumer insofar as it can be done" (§ 6052) and "It is unlawful for any retailer to advertise or hold out or state to the public or to any customer, directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the retailer or that it will not be added to the selling price of the property sold or that if added it or any part thereof will be refunded Any person violating any provision of this section is guilty of a misdemeanor." (§ 6053.)

Appellants and amicus curiae argue that these two sections create a right in the seller to pass the legal obligation on to his customer and a corresponding right in the retailer to collect from his customer the amount of sales taxes he is required to pay. Such contentions were forcefully made almost forty years ago and a number of times since then. On each occasion, these contentions were rejected by the California courts. See e.g., *Western Lithograph Co. v. State Bd. of Equalization,* 11 Cal.2d 156, 162, 78 P.2d 731, (1938), *National Ice, etc. Co. v. Pacific Fruit Express, supra; Pac. Coast Eng. Co. v. State of California,* 111 Cal.App.2d 31, 34, 244 P.2d 21 (1952), *Coast Elevator Co. v. State Bd. of Equalization,* 44 Cal.App.3d 576, 588, 118 Cal.Rptr. 818 (1975).

Section 6053 has been held to pertain solely to advertising practices, and does not in any way effect the rights or obligations of the buyer or seller under a sales agreement. *See DeAryan v. Akers,* 12 Cal. 2d 781, 787, 87 P.2d 695 (1939); *Pac. Coast Eng. Co. v. State of California,* 111 Cal. App. 2d 31, 35, 244 P.2d 21 (1952). Specifically neither sections 6052 nor 6053 give the retailer a right of action against the consumer who has no obligation except as he agrees to reimburse the tax as part of the sales price. *Clary v. Basalt Rock Co.,* 99 Cal. App. 2d 458, 461, 222 P.2d 24 (1950).

Moreover, in 1938, the California Supreme Court rejected the contention advocated by appellants and amicus curiae that it is the intention of the Legislature that in reality the consumer should pay the sales tax. See *National Ice etc. Co. v. Pacific Fruit Express,* 11 Cal.2d 283, 288-89, 79 P.2d 380 (1938), discussed above.

Appellants also fail to discuss or even mention the only final Federal Court decision which construed the legal incidence of the California sales tax. In 1934, the Federal District Court in *Meyer Construction Company v. Corbett, supra,* 7 Fed.Supp. 616 (1934) considered and rejected the same argument made by appellants herein, i.e. that the provision in section 6052 that "The tax hereby imposed shall be collected from the retailer insofar as it can be done" means that the tax is on the purchaser. The federal court recognized that this provision then found in section 8½ of the Sales Tax Act merely "authorized or granted permission to the retailer to reimburse himself for the tax which he must pay to the state to be allowed to sell tangible personal property at retail." 7 Fed.Supp. at page 618. The Court further held:

> "The Retail Sales Tax Act creates the relationship of sovereign power and taxpayer between the state and the retailer, and not between the state and the consumer . . ." 7 Fed.Supp. at page 618.

Moreover, federal governmental agencies for thirty-five years have recognized that the legal incidence of the California sales tax is on the retailer rather than the consumer. Thus, shortly after the passage of the California Retail Sales Tax Act of 1933, the Internal Revenue Service ruled in Revenue Ruling XII-47 6518, IT 2733, that the legal incidence of the California sales tax was on the vendor so that the retailer alone could deduct the tax for federal income tax purposes. A copy of this ruling is attached as Appendix A hereto.[8] Then in Decisions of the Controller A 88689 promulgated on January 31, 1942 (a copy of which is at-

---

8. This ruling was handed down prior to the enactment of section 122 of the Revenue Act of 1942 which expressly made sales taxes imposed on the retailer deductible by the consumer. At this earlier time, consumers could not claim such a deduction if, as in California, the tax was imposed upon and paid by the retailer and not the consumer.

tached to this brief as Appendix B) the United States Controller General clearly recognized that the California sales tax was on the retailer with the result that it was applicable to items purchased as necessary for the proper administration of the unemployment compensation laws and could be included in grants for that purpose.

In sum, under an established history of state and federal judicial and administrative interpretation of the California sales tax law, it has uniformly been held that the California sales tax is imposed upon the retailer for the privilege of engaging in business as such; that the purchaser has no statutory obligation to either the state or the retailer, that the retailer has no statutory right or obligation to collect sales tax or sales tax reimbursement from the purchaser, and that it is merely optional with the parties whether or not to agree by contract to provide for payment of sales tax reimbursement by the purchaser.

**B. THE JURISDICTIONAL STATEMENT IGNORES THE FACT THAT THE CALIFORNIA SALES TAX AND THE MASSACHUSETTS SALES TAX ARE FUNDAMENTALLY DIFFERENT INSOFAR AS THE FORMER MERELY PERMITS OPTIONAL SALES TAX REIMBURSEMENT WHEREAS THE LATTER REQUIRES THAT THE SALES TAX BE PASSED ON TO THE PURCHASER; THIS COURT'S DECISIONS MAKE CLEAR THIS DISTINCTION IS CONTROLLING WITH REGARD TO LEGAL INCIDENCE.**

Although placing primary reliance on the *Berkshire* case, *supra,* the Jurisdictional Statement fails to reflect that drafters of the Massachusetts Sales Tax (which was enacted in 1966) recognized that there was a fundamental difference between their statute (involved in *Berkshire*) and the California statute and that this difference might well preclude the application of the Massachusetts tax to sales to national banks.

The Massachusetts Supreme Court in its decision in *First Agricultural Bank v. State Tax Commission,* 229 NE 2d 245, at 249 (1967) recognized that the Massachusetts Sales Tax



was not a vendor type sales tax like that of the California but was instead a hybrid type sales tax.[9] In this regard, the Massachusetts Supreme Court at page 249 cited with approval an article by Mr. John Dane, Jr. in 51 Mass Law Quarterly 241 in which this distinction was discussed.[10]

In the course of the article Mr. Dane expressed concern over some of the consequences which would flow from the fundamental difference between the purely "vendor type" sales tax (such as exists in California) under which obtaining reimbursement from the purchaser is optional with the retailer and the "hybrid type" Massachusetts sales tax under which the vendor registers and pays the tax over to the State but is required to shift the tax onto the consumer and collect it from him in accordance with the bracket system. Mr. Dane recognized that because of the mandatory pass on requirement in the Massachusetts hybrid type statute there would be problems in taxing national banks which did not arise under the California vendor type statute.[11] 51 Mass. Law Quarterly at 246 to 248.

---

9. While the California sales tax is a privilege tax imposed on a retailer measured by his gross receipts from sales, section 1 of the Massachusetts sales tax law before this Court in Berkshire stated "a tax on retail sales is imposed in accordance with the following subsections: . . ."

10. Mr. Dane was certainly knowledgeable with respect to this matter. At the beginning of the article referred to above his qualifications are described as follows: "Former member and Chairman of the Massachusetts Tax Commission. Mr. Dane served as Special Consultant to Governor Volpe in connection with the preparation of sales tax legislation."

11. At page 265 of the Massachusetts Law Quarterly Article, Mr. Dane stated "As explained above, the Massachusetts tax is a hybrid tax since it is initially imposed on the vendor but shifting to the consumer is mandatory. It cannot be constitutionally imposed on sales to the federal government." The distinction between the California vendor type tax and the Massachusetts hybrid type tax has also been recognized by Mr. John Due, the foremost authority on the sales tax, at page 25 of his book *State and Local Sales Taxation* (1972).

Thus there is a very fundamental difference between the California sales tax and the Massachusetts sales tax, i.e. there is a mandatory pass on requirement under the Massachusetts law which results in the imposition by state action of tax liability on the purchaser. Under the California statute it is merely optional with the retailer whether or not he chooses to obtain sales tax reimbursement by contracting therefore with purchasers.

In the next section hereof we will demonstrate that this Court in *Berkshire* recognized the distinction between a hybrid type tax and a vendor type tax discussed above since it regarded as controlling with regard to legal incidence the mandatory pass on requirement of the Massachusetts statute which has no equivalent under California law. This Court also recognized in *Berkshire* that a vendor type tax could validly apply to sales to federal instrumentalities.

**C. THE DECISION BELOW IS IN ACCORD WITH THE DECISIONS OF THIS COURT.**

In advancing the contention that the *Berkshire* case, *supra,* supports the conclusion that the California sales tax could not validly apply to Diamond's gross receipt from sales to Crocker National Bank, appellants have ignored the standards set forth by this Court in that case. The Court, in addressing the question of whether the legal incidence of the Massachusetts tax was on the purchaser, stated that if the tax was upon vendors who sell tangible property to the bank, "the bank cannot object if a particular vendor decides to pass the burden of the tax on to it through an increase in price. But if this is not true, and if the tax is on the bank as a purchaser, then because it is a national bank, appellant is exempt under 12 U.S.C. § 548." (392 U.S. 339, 347).



This Court then held that "a sales tax which by its terms must be passed on to the purchaser imposes the legal incidence on the purchaser." This Court, in concluding that there was a clear requirement that the Massachusetts sales tax be passed on the purchaser, italicized as set forth below various provisions of subsection 3 of the Massachusetts sales tax law stating that: "Reimbursement for the tax *shall be paid by the purchaser* to vendor and each vendor in this commonwealth *shall add to the sales price and shall collect from the purchaser the full amount of the tax imposed by this section . . .; and such tax shall be a debt from the purchaser to the vendor. . . .*"

The California sales tax law contains no such provisions as those italicized above which this Court regarded as controlling in the *Berkshire* case. Thus, it is clear that appellants' contention that the *Berkshire* rule supports its position herein is devoid of merit.

Several cases decided after *Berkshire* are of significance in reaffirming the standards for evaluating the validity of a tax which is challenged as violating a federal right. On May 12, 1975, this Court rendered its decision in *Gurley v. Rhoden* 421 U.S. 200 (1975).[12] In the *Gurley* case this Court acknowledged the deference to be given to a state court's interpretation of the legal incidence of state taxes. 421 U.S. 200 at 208.

The best appellants can do to escape the impact of the *Gurley* case in this regard is to suggest that the standard it sets forth does not apply if a federal exemption from state taxes is involved. Suffice it to say that the distinction which appellants seek to make does not find support in the

12. In the *Gurley* case the Court considered the legal incidence of both the federal excise tax on gasoline and the Mississippi excise tax on gasoline.

*Gurley* case. Moreover, this court in *Colorado National Bank v. Bedford,* 310 U.S. 41, at 52, (1940) enunciated this same standard in a case involving state taxation affecting national banks.

This Court in *Gurley v. Rhoden, supra,* in making its determination with respect to the incidence of the federal excise tax, rejected contentions similar to those raised by appellants herein. Thus the Court dismissed as irrelevant the fact that it was contemplated that the economic burden of the tax would be passed on to the purchasers. 421 U.S. 200 at 204. This is clearly consistent with *Berkshire* where this Court said that if it were true that the tax was on the vendor "the bank cannot object if a particular vendor decides to pass the burden of the tax on to it through an increased price . . ." 392 U.S. 339 at 346, 347.

Highly significant is the manner in which this Court in *Gurley,* in holding the legal incidence of the federal gasoline tax was on the producer, distinguished the *Berkshire* case on the basis of the mandatory pass on requirement under the Massachusetts sales tax law which resulted in making the vendee liable for payment. 421 U.S. 200 at 206.

About three weeks after the decision in *Gurley v. Rhoden,* in *United States v. Mississippi Tax Commission, supra,* this Court struck down a Mississippi markup tax on liquor sold to military installations when the failure of the distiller to pass on the tax could result in criminal penalities and might also result in forfeiture of its license to operate in Mississippi. In this decision this Court cited the *Berkshire* case as involving a mandatory pass on requirement. In this latter Mississippi case, the State action, i.e., the regulation, violated the principle of federal supremacy by requiring that a state tax be passed on to a federal instrumentality.



In view of these later decisions of this Court which cite and discuss the *Berkshire* case, *supra,* it seems too clear for argument that as a matter of federal law the legal incidence of an excise tax payable by a vendor does not fall on a purchaser unless there is a mandatory requirement that the tax be passed on to such purchaser.

### D. THE ARGUMENTS OF APPELLANTS ARE WITHOUT MERIT.

In the prior discussion we have shown the fundamental differences between the vendor type sales tax imposed by California which is only on the vendor and the hybrid type Massachusetts sales tax with its mandatory pass on requirement which constitutes state action affecting the liability of the purchaser. We have also demonstrated that the test of legal incidence suggested by appellants is drastically different from the actual test of legal incidence of a tax enunciated in the *Berkshire* and the subsequent decisions in *Gurley v. Rhoden, supra,* and *United States v. Mississippi Tax Commission, supra.* It will be shown herein that the remaining authorities relied upon by appellants similarly fail to support their position.

Appellants' reliance upon *DeAryan v. Akers,* 12 Cal.2d 781, 87 P.2d 695 (1939) is misplaced. In *DeAryan,* the Court held that the legal incidence of the sales tax was on the retailer and that insofar as the purchaser was concerned sales tax reimbursement was merely part of the purchase price agreed upon and nothing more. While the *DeAryan* case recognizes that the economic burden of the sales tax will usually be borne by the purchaser, it held, as did this Court in *Gurley v. Rhoden, supra,* that this was irrelevant with respect to determining the legal incidence of the tax.

Contrary to the assertion of appellants (J.S. 14), the *DeAryan* case does not hold that if a retailer separately

states the tax, he may collect it from the consumer as a debt. This is simply not the California law. It is clear under California law that unless the purchaser contracts to pay the sales tax reimbursement at the time the sale is made, the retailer is precluded from collecting sales tax reimbursement. *National Ice, etc. Co. v. Pacific Fruit Express,* 11 Cal.2d 283, 79 P.2d 380 (1938); *Pacific Coast Engineering Co. v. State of California, supra.*

The cases cited above make it clear that under California law a retailer who fails to obtain sales tax reimbursement from the purchaser is not thereby relieved of liability to the state. A California retailer does not have a right to collect any amount of sales tax reimbursement unless the purchaser agrees to pay such sum.

Appellants seek to attach significance to the fact that if a retailer has improperly collected sales tax reimbursement from his customers, the retailer obtaining a refund must pay back the overreimbursement to the purchasers. *Decorative Carpets Inc., v. State Board of Equalization,* 58 Cal.2d 252, 373 P.2d 673 (1962); *Javor v. State Board of Equalization.* 12 Cal.3d 790, 527 P.2d 1153 (1974).

In *Javor,* the California Supreme Court held that if sales tax reimbursement is overpaid by mistake, the purchaser has no direct claim against the State Board of Equalization but in certain unique situations may join the Board in a class action against retailers to insure that the overreimbursement is refunded to the retailers for distribution to the purchasers. There is not the slightest suggestion in *Javor* that the retailer was required to pass the tax on to the purchaser. The Court held it necessary, however, that the retailer be a party to any litigation to recover any overpayment. This Court in *Gurley v. Rhoden,* 421 U.S. 200 at 206 (1975) held that even though under the statute there



involved the purchaser could get a direct refund from the government of tax paid on gasoline used for non-highway purposes, this did not affect the Court's conclusion that the legal incidence of the tax was on the seller.

The appellants also seek to attach significance to the fact that it is the general practice of California retailers to seek to cover their costs by adding sales tax reimbursement as a component to the total price charged. Unfortunately for appellants, this Court has declared that as long as the tax is imposed on the vendor, it may be validly applied even though the vendor increases his price to a federal instrumentality because of the tax. *Berkshire, supra;* see also *Gurley v. Rhoden, supra.*

The appellants further cite excerpts from certain legislative materials published decades after the California Sales Tax Act was enacted in support of the proposition that the incidence of the California sales tax is on the purchaser. It is noteworthy that the Court in *Gurley* in rejecting a similar argument with respect to a Congressional report, said:

> "But these references obviously were not made in the context of consideration of the legal incidence of the gasoline tax but merely as recognition that the reality is that users bear the economic burden of the tax." 421 U.S. 200 at 207.

The Court then dismissed these references as being irrelevant.

The appellants, in an effort to establish the importance of this case, refer to a federal decision involving the Nevada sales tax, which they allege is in conflict with the decision in the instant case (*United States v. Nevada Tax Commissions,* 291 F.Supp. 530 (D.Nev. 1968 aff'd 439 F.2d 435 (9th Cir. 1971)). They neglect to point out that the

federal courts were accepting the interpretation of the Nevada statute by the Nevada Attorney General who had concluded that the legal incidence of the Nevada sales tax falls on the purchaser.[13] Moreover, the federal District Court noted at page 533 that under Nevada law (unlike that of California) the retailer receives a commission for collecting the sales tax from the purchaser.

Appellants' assertion at page 20 of the Jurisdictional Statement that this Court should retain jurisdiction of this case because otherwise other states might change their laws to tax federal instrumentalities will not stand close analysis. This Court has established standards as to legal incidence which will determine the validity of a state tax as it relates to federal instrumentalities. The criteria applied by the Court of Appeal in the instant case correctly applies those criteria. Accordingly there is no occasion for this Court to restate its established standards as to this matter.

**E. THE ARGUMENTS OF AMICUS CURIAE ARE WITHOUT MERIT.**

The Solicitor General expresses an interest in this case by virtue of pending litigation involving the imposition of sales tax with respect to leases to the federal government. The case in question is *United States v. State Board of Equalization*, C.A. 9, No. 74-3360. That case presents an additional issue, i.e. discrimination against the United States. In that case the trial court without opinion ruled that for federal purposes the legal incidence of the California sales tax was on the purchaser and therefore could not be validly applied to leases to the United States.

The findings of fact and conclusions of law of the District Court in that action are set forth in Appendix C

13. See Opinion of the Attorney General No. 540, September 18, 1968 (CCH State Tax Reporter, Nevada, Par. 200-455)



to the Jurisdictional Statement. It is to be noted that the trial court concluded that the sales tax was invalid without regard to whether the United States was contractually obligated to reimburse the retailer or not. There is no doubt support for such a conclusion in *Panhandle Oil Co. v. Knox*, 277 U.S. 218 (1928) which held invalid a sales tax on a retailer to the United States Government even though the tax might not be passed on by the retailer. However, in *Alabama v. King & Boozer*, 314 U.S. 1 at 8, 9 (1941), this Court expressly rejected the principle of the *Panhandle Oil* case. While this Court is moving in the direction of removing restrictions on State taxation in cases such as *Michelin Tire Corp. v. Wages*, 44 L.W. 4070 (Jan. 14, 1976), the federal government is retreating toward a nineteenth century concept of all encompassing intergovernmental immunity insofar as state taxes are concerned.[14] Cf. *United States v. City of Detroit*, 355 U.S. 466 (1958).

While the amicus curiae brief makes several references to *Kern Limerick Inc. v. Scurlock*, 347 U.S. 110 (1954), that case is not in point. That case involved the status of the purchaser. It was held that the sales there involved qualified for an express statutory exemption in the Arkansas Gross Receipts Tax Law as "sales to the United States." No question is raised in the instant case or in *United States v. State Board of Equalization, supra*, as to the status of the purchaser involved.

14. Thus the District Court in the above case accepted the argument of the federal government that a sales tax on retailers to the federal government is "invidiously discriminatory" against the federal government even though there is a use tax of equal magnitude borne by other lessees. This involves a disregard of principles established by this Court in cases such as *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937) and *Tradesmens Bank v. Tax Comm'n.*, 309 U.S. 560 (1939) that there is no discrimination against a federal instrumentality or against interstate commerce unless there is a greater tax burden thereon, giving consideration to the total tax structure of the State.

The Solicitor General makes no arguments in addition to those raised by appellants in the Jurisdictional Statement. It is to be observed that the brief of amicus curiae, although challenging the holding of the California state courts that the tax is imposed on the retailer, avoids considering the actual operation of the California sales tax for 40 years, to which the United States has expressly stipulated. (See Appendix C); *St. Louis S.W. Ry Co. v. Arkansas,* 235 U.S. 350, 362 (1914). Nor does it consider the significant differences between the vendor type California tax and the hybrid type Massachusetts tax discussed herein. Accordingly, the amicus curiae brief is neither informative nor persuasive.

## CONCLUSION

Wherefore, appellee respectfully submits that the issue here involved is so unsubstantial as not to need further argument, and appellee respectfully moves the Court to dismiss the appeal or, in the alternative, to affirm the judgment entered in the case by the California Court of Appeal.

Respectfully submitted.

EVELLE J. YOUNGER
Attorney General
ERNEST P. GOODMAN
Assistant Attorney General
PHILIP M. PLANT
Deputy Attorney General
*Attorneys for Appellee,*
*State Board of Equalization*

**(APPENDICES FOLLOW)**

# APPENDIX

ARTICLE 151: Taxes. XII 47 6518
I. T. 2733

REVENUE ACT OF 1932.

The tax imposed under the provisions of the California retail sales tax act of 1933 is an excise tax imposed by the State on the vendor for the privilege of engaging in the business of making sales at retail. For Federal income tax purposes the tax is an allowable deduction as a tax under section 23(c) of the Revenue Act of 1932 to the vendor only, upon whom it is imposed and who is liable for its payment. Where the vendor collects the amount of the tax from the vendee he must include the amount so collected in his gross income. The amount equivalent to the tax paid by the purchaser constitutes additional cost to him of the article purchased.

Advice is requested whether the California sales tax, imposed upon the vendor for the privilege of engaging in the business of making sales at retail, is an allowable deduction by the vendor or the vendee for Federal income tax purposes.

The law under which the tax is imposed is the "Retail sales tax act of 1933." Section 3 provides:

SEC. 3. For the privilege of selling tangible personal property at retail a tax is hereby imposed upon retailers at the rate of 2½ per cent of the gross receipts of any such retailer from the sale of all tangible personal property sold at retail in this State on and after August 1, 1933, and to and including June 30, 1935; and at the rate of 2 per cent of the gross receipts of any such retailer from the sale of all tangible personal property sold at retail in this State on and after July 1, 1935. Such tax shall be paid at the time and in the manner hereinafter provided and shall be in addition to any and all other taxes.

Other provisions of the law, so far as pertinent to the discussion of the question presented, read as follows:

SEC. 2. The following words, terms and phrases when used in this act have the meanings ascribed to them in this section, except where the context clearly indicates a different meaning:

* * * * * * *

(f) "Gross receipts" means the total amount of the sale price of the retail sales of retailers, including any services that are a part of such sales, valued in money, whether received in money or otherwise, including all receipts, cash, credits and property of any kind or nature, and also any amount for which credit is allowed by the seller to the purchaser, without any deduction therefrom on account of the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses or any other expense whatsoever; provided, however, that cash discounts allowed and taken on sales shall not be included, and "gross receipts" shall not include the sale price of property returned by customers when the full sale price thereof is refunded either in cash or by credit, nor shall "gross receipts" include the price received for labor or services used in installing, applying, remodeling or repairing the property sold.

For the purpose of this act the total amount of the sale price above mentioned shall be deemed to be the amount received exclusive of the tax hereby imposed; provided, that the retailers shall establish to the satisfaction of the board that the tax imposed hereunder had been added to the sale price and not absorbed by the retailer.

(g) "Board" means the State Board of Equalization.

BEST COPY AVAILABLE

* * * * * * *

SEC. 8. It shall be unlawful for any retailer to advertise or hold out or state to the public or to any customer, directly or indirectly, that the tax or any part thereof imposed by this act will be assumed or absorbed by the retailer or that it will not be added to the selling price of the property sold, or if added that it or any part thereof will be refunded. Any person violating any of the provisions of this section shall be guilty of a misdemeanor.

SEC. 8½. The tax hereby imposed shall be collected by the retailer from the consumer in so far as the same can be done. * * *

SEC. 9. The tax levied hereunder shall be a direct obligation of the retailer and shall be due and payable in quarterly installments on or before the 15th day of the month next succeeding each quarterly period * * *.

* * * * * * *

SEC. 12. Thirty days after the effective date of this act, it shall be unlawful for any person to engage in or transact business as a retailer within this State, unless a permit or permits shall have been issued to him as hereinafter prescribed. * * *

The tax imposed under the provisions of the California retail sales tax act of 1933 is an excise tax imposed by the State on the vendor for the privilege of engaging in the business of making sales at retail. For Federal income tax purposes the tax is an allowable deduction as a tax under section 23(c) of the Revenue Act of 1932 to the vendor only, upon whom it is imposed and who is liable for its payment. Where the vendor collects the amount of the tax from the vendee, he must include the amount so collected in his gross income. The amount equivalent to the tax paid by the purchaser constitutes additional cost to him of the article purchased.

In the case of a vendor whose books are kept on the accrual basis, the amount of the tax actually accrued during the period covered by his Federal income tax return may be deducted in determining his net income. Where the vendor's books are kept on the cash receipts and disbursements basis, only the amount of the tax actually paid during the period covered by his Federal income tax return may be deducted in determining his net income.



(A-88689)

## STATE SALES TAXES—INCLUSION IN FEDERAL AID UNEMPLOYMENT COMPENSATION ADMINISTRATION GRANTS

**The Social Security Board is authorized to include in its grants under section 302 (a) of the Social Security Act to the State of California for unemployment compensation administration an amount representing the California retail sales tax—the legal incidence of which is upon the vendor—which the department of employment or other agency of the State is required to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the unemployment compensation laws of that State. 17 Comp. Gen. 223, modified.**

**Comptroller General Warren to the Federal Security Administrator, January 31, 1942:**

With reference to the decision of September 8, 1937, of this office to the Chairman, Social Security Board, 17 Comp. Gen. 223, wherein it was held that the Social Security Board is not authorized to include in its grants to States the amount of the State sales tax which the State agencies are required under State laws to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the State unemployment compensation laws, there has been received from Fred E. Stewart, a member of the State Board of Equalization of the State of California, a letter dated December 9, 1941, reading as follows:

> The Department of Employment of the State of California informed us that the Acting Comptroller General of the United States on September 8, 1937, advised the Social Security Board that it was not authorized to include in its grants to this State under the provisions of section 302 (a) of the Social Security Act "the amount of the State sales tax which the State agencies are required under State laws to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the State unemployment compensation laws." The reason given in the opinion is that "the appropriation of Federal funds" is not "available for that purpose."
>
> One of the items in the budget which was presented to the Social Security Board by the Unemployment Reserves Commission of this State was "the amount of State sales tax paid in connection with the purchase of supplies and equipment necessary for the administration of the State unemployment compensation laws," and the Social Security Board requested your advice as to whether it was authorized to include in its grants to this State the amounts so itemized and described in the budget. The request, in our opinion, did not disclose the true nature and legal incidence of the California Retail Sales Tax Act.
>
> The Social Security Board has withheld from its grants to the State the budgeted items described above. Vendors selling supplies and equipment to the State of California for use by the department of employment, a State agency, have, accordingly, been unable to collect the full amount of the selling price, which results in confusion and misunderstanding.
>
> The nature of the California tax is set forth in section 3 of the California Retail Sales Tax Act, which provides:
>
> "For the privilege of selling tangible personal property at retail a tax is hereby imposed upon retailers * * * at the rate of 3% of the gross receipts of any such retailer from the sale of all tangible personal property sold at retail in this State * * *."

The term "retailer" is defined by section 2, subdivision (c) of the act as:

"Every person engaged in the business of making sales at retail • • • of tangible personal property • • •."

The nature of the tax has been uniformly construed by not only the State, but the Federal courts, as a tax upon vendors for the privilege of engaging in business at retail, and its legal incidence has been determined to be upon the seller and not upon the purchaser.

In *Western Lithograph Co.*, v. *State Board of Equalization*, 11 Cal. (2d) 158, 164, the California Supreme Court stated:

"The tax being a direct obligation of the retailer and, so far as the consumer is concerned, a part of the price paid for the goods and nothing else, it is neither in fact nor in effect laid upon the consumer. It does not become a tax on the sale nor because of the sale, but remains an excise tax for the privilege of conducting a retail business measured by the gross receipts from sales."

In addition to the *Western Lithograph Co., case, supra*, the following cases definitely place the legal incidence of the tax upon the seller:

*Roth Drugs, Inc.*, v. *Johnson*, 13 Cal. App. (2d) 720.
*Meyer Construction Company* v. *Corbett*, 7 Fed. Supp. 616.
*People* v. *Herbert's of Los Angeles*, 3 Cal. App. (2d) 482.
*Graham Brothers, Inc.*, v. *City of Los Angeles*, 6 Cal. App. (2d) 203.
*National Ice & Cold Storage Co.*, v. *Pacific Fruit Express Co.*, 11 Cal. (2d) 283.
*DeArgan* v. *Akers*, 12 Cal. (2d) 781, Certiorari denied by U. S. Supreme Court, Oct. 9, 1939, Mem. 308 U. S. 581.

In *Roth Drugs, Inc.*, v. *Johnson*, *supra*, the Court stated at page 736:

"This act does not impose the tax on the consumer. The last-mentioned section (sec. 8½) merely authorizes the retail merchant to reimburse himself from the consumer insofar as it may be consistently done. He is not required to do so. He may waive that right. Section 8 of the act merely declares that it shall be unlawful for the retailer to advertise that he will assume and pay the tax or that he will not add it to the price of his merchandise upon sale thereof. In considering the entire act we are impelled to hold it is merely optional with the retail merchant as to whether he will reimburse himself from his customers for the tax he is compelled to pay. The act specifically declares that the tax is imposed on retail merchants, and not on the consumers. Section 3 provides in that regard, 'for the privilege of selling tangible personal property at retail a tax is hereby imposed upon retailers.' Section 9 of the act further provides that 'The tax levied hereunder shall be a direct obligation of the retailer.' Section 12 of the act prohibits any retail merchant from maintaining his business without first procuring a permit therefor as provided by that measure."

The amount of the purchase price is a matter of contract between the seller and the purchaser, each being free to refrain from selling or buying, as the case may be, except on such terms as to him may seem proper. The seller in order to determine the selling price of the merchandise must as a matter of course consider the amount of property, income, franchise, excise, and similar taxes, which he is called upon to pay by local, State, or Federal Government. Any tax, the legal incidence of which is upon the seller, cannot be disregarded by him in determining the selling price.

On November 10, 1941, the Supreme Court of the United States in two cases, *The State of Alabama* v. *King and Boozer*, 62 Sup. Ct. 43, 86 L. Ed. (Adv. Op.) 1, and *John C. Curry* v. *United States*, 62 Sup. Ct. 48, 86 L. Ed. (Adv. Op.) 6, considered the application of the Alabama sales and use taxes in connection with purchases made by "cost-plus-a-fixed-fee" contractors with the Federal Government.

The Court in the *King and Boozer case* stated:

"The Government, rightly we think, disclaims any contention that the Constitution, unaided by Congressional legislation, prohibits a tax exacted from the contractors merely because it is passed on economically, by the terms of the contract or otherwise, as a part of the construction cost to the Government. So far as such a nondiscriminatory State tax upon the contractor enters into the cost of the materials to the Government, that is but a normal incident of the



organization within the same territory of two independent taxing sovereignties. The asserted right of the one to be free of taxation by the other does not spell immunity from paying the added costs, attributable to the taxation of those who furnish supplies to the Government and who have been granted no tax immunity. So far as a different view has prevailed, see *Panhandle Oil Co.* v. *Knox, supra*; *Graves* v. *Texas Co., supra*, we think it no longer tenable."

The Court in the *Curry case* in considering the economic effect upon the Government makes the following statement:

"For the reasons stated at length in our opinion in the *King and Boozer case* we think that the contractors, in purchasing and bringing the building material into the State and in appropriating it to their contract with the Government, were not agents or instrumentalities of the Government; and they are not relieved of the tax, to which they would otherwise be subject, by reason of the fact that they are Government contractors. If the State law lays the tax upon them rather than the individual with whom they enter into a cost-plus contract like the present one, then it affects the Government, like the individual, only as the economic burden is shifted to it through operation of the contract. As pointed out in the opinion in the *King and Boozer case*, by concession of the Government and on authority, the Constitution, without implementation by Congressional legislation, does not prohibit a tax upon Government contractors because its burden is passed on economically by the terms of the contract or otherwise as a part of the construction cost to the Government."

In view of these recent decisions, we respectfully request that you give further consideration to this problem, and that you advise the Social Security Board that it may include in its grants to the State of California the entire amount which the department of employment is required to pay in connection with the purchase of supplies and equipment for the administration of the California Unemployment Reserves Act without the deduction of any amount which may improperly be designated as a tax, but which actually constitutes a part of the purchase price of supplies and equipment.

Section 302 (a) of the Social Security Act, 49 Stat. 626, provides, in part—

> The Board shall from time to time certify to the Secretary of the Treasury for payment to each State which has an unemployment compensation law approved by the Board under title IX, such amounts as the Board determines to be necessary for the proper administration of such law during the fiscal year in which such payment is to be made. • • •

The decision of September 8, 1937, *supra*, apparently was predicated to a considerable extent upon the ruling of the Supreme Court of the United States in the case of *Panhandle Oil Co.* v. *Mississippi ex rel. Knox*, 277 U. S. 218, to the effect that the vendor of gasoline sold to the United States was exempt from the payment of an excise tax measured by the quantity of gasoline sold upon the theory that the tax fell upon the Government. However, a careful examination of the recent decision of the Supreme Court of the United States in the case of *State of Alabama* v. *King and Boozer*, 314 U. S. 1, 86 L. ed. (Adv. Ops.) 1, leaves little or no room for doubt that a vendor who sells supplies to the United States is not exempt from the payment of a State sales tax upon the transaction unless the legal incidence of the tax is upon the vendee. And the holding of the Supreme Court of California is that the legal incidence of the retail sales tax

of that State is upon the vendor (*Western Lithograph Co.* v. *State Board of Equalization, et al.*, 11 Cal. (2d) 156), so that the tax is not to be regarded as being passed on, as such, to the purchaser. Cf. *Lash's Products Co.* v. *United States*, 278 U. S. 175.

Such being the case it would appear that the price paid by the department of employment or other agency of the State of California for such supplies or equipment purchased by it as are "necessary for the proper administration" of the State's unemployment compensation laws may not be viewed as including, as such, the tax imposed on vendors by the provisions of the California Retail Sales Tax Act of 1933, as amended, although the sale price of the supplies or equipment may have been increased by reason of the imposition of such tax on the vendor; and as it thus appears that the tax loses its identity as such and is merged in the purchase price paid by the State agency, the theory that grants which may be made to the State to cover the additional expense would be diverted to the payment of a State tax seems no longer tenable. Cf. decision of August 2, 1940, to you.

Accordingly, in view of the foregoing, I have to advise that the Social Security Board is authorized to include in its grants to the State of California for the purpose set forth in section 302 (a) of the Social Security Act the entire amount which the department of employment or other State agency is required to pay in connection with the purchase of supplies and equipment the Board finds necessary for the proper administration of the unemployment compensation laws of that State without the deduction of any amount on account of the additional expense incurred by reason of the tax imposed by the provisions of the California Retail Sales Tax Act of 1933, as amended.

BEST COPY AVAILABLE



## *Appendix C*

William D. Keller
*United States Attorney*
Charles H. Magnuson
*Assistant U. S. Attorney*
*Chief, Tax Division*
Arthur M. Greenwald
*Assistant U. S. Attorney*
1142 U. S. Courthouse
312 North Spring Street
Los Angeles, California 90012
Telephone: 688-2455-2410
*Attorneys for United States of America*

*In the United States District Court for the Central District of California*

Civil No. 72-2568-R

United States of America,
*Plaintiff*

vs.

State Board of Equalization,
*Defendant*

### STIPULATION OF FACTS

The parties to this action, by their undersigned attorneys, hereby stipulate and agree that the following facts shall be deemed true and correct for the purpose of any hearing or trial herein; at any hearing or trial of this action, any party may offer any further evidence not inconsistent with any facts below stated; and each party reserves the right to

object to the admissibility, on any appropriate ground, of any further evidence offered by any other party.

1. This action is brought at the request of plaintiff's General Services Administration and under the direction of the Attorney General of the United States.

2. Defendant is authorized to and administers and enforces the provisions of Parts 1, 1.5 and 1.6 of Division 2 of the Calito.nia Revenue and Taxation Code (hereafter referred to as the "California Sales and Use Tax Law") and the local ordinances enacted pursuant thereto.

3. The amount in controversy exceeds ten thousand ($10,000) dollars, exclusive of interest and costs; plaintiff asserts invalidity under the Constitution of the United States; and the action is commenced by the United States.

4. The plaintiff, through its departments and agencies, has leased since August 1, 1965 and continues to lease data processing equipment and other tangible personal property in California from various lessors.

5. Since 1965 when the California Sales and Use Tax Law was amended, the defendant has taken the position that, under the California Sales and Use Tax Law, the lessors' gross receipts from leases of property in California to the Federal Government, state banks, national banks or insurance companies are includable in the measure of the lessors' sales tax.

6. These lessors have, since on or about October 31, 1965, remitted to the defendant substantial amounts in sales taxes measured by such leases.

7. Under many of the agreements between the plaintiff and its lessors, the plaintiff is contractually obligated to reimburse its lessors an amount equal to the amount of



sales tax paid by the lessors measured by such leases; since October 1, 1966, the plaintiff has reimbursed certain of its lessors for some of the sales taxes remitted by them to the Board. The amount reimbursed by the plaintiff is substantial (plaintiff believes that it is in excess of $1,000,000). Under many of such agreements, it was agreed between the plaintiff and its lessors that plaintiff is entitled to the benefit of any recovery by the lessors of sales taxes paid by the lessor to the Board.

8. Plaintiff believes that there may be some leases in which plaintiff has neither agreed to pay nor paid sales tax reimbursement to its lessors, but if so, the comparative dollar amount is small. In such cases, the lessors would have included their gross receipts in their sales tax measure and have no rights or claims against plaintiff arising therefrom.

9. In this action plaintiff contends that as a matter of Federal law the legal incidence of the sales tax falls on the Federal Government as lessee regardless of whether or not the Federal Government has contracted to reimburse to its lessors amounts of California Sales Tax paid by the lessors. Plaintiff contends that the contractual arrangement between the Federal Government and the lessor has no bearing on where the legal incidence of the sales tax falls. In this action, however, the Federal Government seeks recovery only in the amount of those taxes paid by its lessors for which the Federal Government has reimbursed its lessors.

10. On October 14, 1969, plaintiff brought an action for declaratory judgment and refund of taxes in the United States District Court for the Central District of California, civil number 69-2050-JWC, captioned *United States v. State Board of Equalization* (hereinafter referred to as the "Federal Court Action").

11. On October 7, 1970, the United States District Court for the Central District of California granted defendant's motion to dismiss said Federal Court Action "without prejudice to plaintiff's right to litigate in any United States Court, after a state determination of state issues, any federal issue withheld from submission to the state court."

12. On June 28, 1971, plaintiff brought an action for declaratory judgment in the Superior Court of the State of California in and for the County of Los Angeles, civil number C 6215 (hereafter referred to as the "State Court Action") for the sole purpose of obtaining a determination of the issues of state law which it raised in the earlier Federal Court Action and wished to pursue.

13. In the State Court Action, plaintiff withheld from submission to the state court its "federal claim for refund of taxes" and all questions on federal law. It was plaintiff's view that for purposes of plaintiff's claim of federal constitutional immunity, the questions of (a) where the legal incidence of the tax which has been imposed falls when the lessee is the Federal Government and (b) whether that tax discriminates in violation of the Federal Constitution against the plaintiff and those with whom it deals are federal questions.

14. On July 20, 1972, the Superior Court of the State of California in and for the County of Los Angeles entered its order that the tax imposed with respect to the transactions described herein "is a sales tax, not a use tax."

15. This action is brought in order that the federal issues raised by plaintiff may now be litigated.

16. Under the California Sales and Use Tax Law:

(a) Since 1933, sales tax is imposed on a seller for the privilege of selling tangible personal property in California



at retail; the legal obligation to pay the sales tax is on the seller; the buyer has no obligation to or rights against the State of California; a sales tax may be lawfully imposed even though the user be exempt from sales and use tax; the seller has no rights (except those created by contract between seller and buyer) to reimburse to himself or otherwise recover from the buyer the amounts of sales tax paid by the seller; it is the prevailing (but not uniform) practice, however, for the buyer and seller to separately state and collect sales tax reimbursement in their sales agreement;

(b) Since 1935, use tax is imposed on a user of tangible personal property purchased for use in California from a retailer;

(c) Since 1965, a lessor of tangible personal property in California is a seller subject to sales tax under (a) *supra* and a lessee is a user subject to use tax under (b) *supra;*

(d) Since 1935, transactions subject to sales tax are exempt from use tax; except that since 1965, with respect to leases, transactions subject to use tax are exempt from sales tax and a use tax is payable with respect to all leases (except leases where the lessee is exempt from tax, for example, the Federal Government, banks and insurance companies).

(e) The Federal Government, certain agencies and instrumentalities of the United States, banks and insurance companies are exempt entities upon whom neither sales nor use taxes may be imposed.

17. The California law set out in Paragraph 16(a) *supra* represents a consistent and repeated forty-year interpretation of the sales tax administrator, California Legis-

lature, California Attorney General and state and federal courts.

18. The Federal Government does not challenge the statements of California law in paragraph 16 insofar as they affect anyone other than the Federal Government, its agencies and instrumentalities. The Federal Government contends, under its interpretation of the decisions of the United States Supreme Court, that when a tax affects federal immunity, the question of where the legal incidence of that tax falls is a federal question and the courts are not bound by a state's characterization of its statute.

19. Since 1933, gross receipts from sales to banks, insurance companies, and (to the extent not exempted by California law) to the Federal Government have been included in the measure of the seller's sales tax.

20. There are numerous leases of tangible personal property in California to state banks, national banks and insurance companies, the gross receipts from which have been since 1965 included in the measure of the lessors' sales tax.

21. The United States until November 1968 did not in any way dispute California's interpretation of its sales tax law that the legal obligation thereof is upon the retailer. Attached are a decision of the Comptroller General, A-88689, January 21, 1942; a letter from General Services Administration of the United States to the State Board of Equalization of California dated March 15, 1967; and a letter dated April 5, 1968 from the Office of General Counsel of the United States General Accounting Office addressed to Hertz Corporation. The United States has found no other relevant letters or documents prior to



November 1968 reflecting legal analysis of the California Sales Tax Law in its files.

Dated: May 18, 1973

WILLIAM D. KELLER
United States Attorney

CHARLES H. MAGNUSON
Assistant U. S. Attorney
Chief, Tax Division

ARTHUR M. GREENWALD
Assistant U. S. Attorney

/s/ ARTHUR M. GREENWALD

Arthur M. Greenwald

*Attorneys for Plaintiff*

EVELLE J. YOUNGER
*Attorney General*

By: NEAL J. GOBAR

Neal J. Gobar
*Deputy Attorney General*

*Attorneys for Defendant*

**(Exhibits Omitted)**